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CHARLES ELMORE CROP

IN THE

Supreme Court of the United States

No. 142 .

October Term, [redacted] 1952

ESTATE OF HENRY HAUPTFUHRER, Deceased, Henry Hauptfuhrer, Jr., George J. Hauptfuhrer, and Albert F. Hauptfuhrer, Executors,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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IN THE

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October Term, 195

No.

ESTATE OF HENRY HAUPTFUHRER, DECEASED, HENRY HAUPTFUHRER, JR., GEORGE J. HAUPTFUHRER, AND ALBERT F. HAUPTFUHRER, EXECUTORS,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, Henry Hauptfuhrer, Jr., George J. Hauptfuhrer, and Albert F. Hauptfuhrer, Executors of the Estate of Henry Hauptfuhrer, deceased, pray that a writ of certiorari issue to the United States Court of Appeals for the Third Circuit, which affirmed the decision of the Tax Court sustaining respondent in holding petitioners liable for deficiency in estate tax of $118,821., by reason of the inclusion therein of the value of the remainder interests in three inter vivos trusts.

STATEMENT OF THE MATTER INVOLVED.

Petitioners are the three sons and the duly appointed executors of the estate of Henry Hauptfuhrer, who died on September 20, 1943, a resident of Montgomery County, Pennsylvania.

On April 8, 1933, the decedent created three inter vivos deeds of trust (exhibits 1, 2 and 3) (App. pp. 18a-46a), one for the benefit of each of these sons, Henry, Jr., George J. and Albert F., all of whom were sui juris, and in all three deeds designated the three sons and The Pennsylvania Company as trustees. The three sons thus constituted a "majority" of the trustees. To the trusts he transferred 30,000 shares National Dairy Products Corporation common stock, giving to each trust 10,000 shares. The terms of each trust are the same except as to the name of the primary beneficiary, the pertinent provisions being as follows:

(1) "In Trust, to pay and distribute *the net income* from the trust estate at least quarter-yearly *unto* (*George J.*) Hauptfuhrer, *during his life;* and

(2) "In Trust, during the life of (George J.) Hauptfuhrer, to pay and distribute unto him such part or parts or the whole of the principal of the trust estate as he shall, by writing lodged with the Trustees, request, provided such request be in writing *approved by the settlor during his lifetime, and after the decease of the settlor by the trustees, or a majority of them,* and to the extent of such distributions of principal the interests of all persons therein shall be thereby terminated and ended; and

(3) "In Trust, from and after the death of (George J.) Hauptfuhrer, then to pay and distribute the net income from the then remaining trust estate, if any, and the then remaining principal thereof unto and among such person or persons related to (George J.) Hauptfuhrer by blood or marriage and/or for such

charities or religious purposes as (George J.) Hauptfuhrer, *by writing lodged with the trustees* or by last will and testament, shall nominate and appoint, in such manner, at such times and for such interests, as he shall determine; and any part of the trust estate, both income and principal, which shall not be or become subject to distribution under the power aforesaid shall be paid and distributed upon the death of (George J.) Hauptfuhrer, unto his then surviving children and issue[1] • • •

• • • • • •

(4) "In Trust, anything hereinbefore to the contrary notwithstanding, if by reason of misfortune, lack of income or other cause, the share of principal and/or income payable to any person hereunder shall not be sufficient, in the opinion of the Trustees, for the proper care, maintenance, education and support of such person, then the Trustees shall be entitled, in their sole and absolute discretion, to apply out of the principal from which such person is receiving or entitled to receive income, or out of the residuary trust estate, such part or parts thereof as the Trustees shall determine, and to the extent of such application the interest of all persons therein shall be thereby diminished; • • •"

(5) "It is hereby expressly stipulated and agreed that all payments of income and/or principal payable to any person hereunder shall, to the fullest extent permitted by law, be free and clear of his or her debts, contracts, engagements, alienations and anticipations, and that

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1. The important features of this provision are:

(1) that the son had power to appoint not only by his last will, but by an assignment executed immediately;

(2) that he might appoint to any relative of his, which would include his father (the settlor) or either or both of his brothers;

(3) that the gift over to his surviving children and issue was only of the part of the income and principal which was not distributed under the son's power.

the same shall not be liable to any levy, attachment, execution or sequestration.

* * * * * *

(6) "It is hereby expressly stipulated and agreed that during the life of the settlor the settlor shall be entitled to direct and control the exercise by the trustees hereunder of the powers and authority herein conferred upon the Trustees, * * *".

* * * * * *

The last provision states:

(7) "The settlor hereby expressly agrees that the trust created hereby is irrevocable, and that the trust estate and all rights, powers and authority hereunder vested in the trustees, and their successors, and/or the survivor or survivors of them, upon the date hereof without any right being reserved in the Settlor to receive any principal or income from the trust estate, or to alter, amend or modify any rights or interest therein; and the settlor hereby acknowledges this trust and the said assignment and transfer to be irrevocable and to be vested as aforesaid." (Emphasis and paragraph numbers supplied.)

The Tax Court sustained the action of the Commissioner in imposing estate tax on the value of the remainder interests in the three trusts, the clause of the Internal Revenue Code relied on by the Commissioner being Section 811(d)2, entitled "Revocable Transfers" which provides for the inclusion in the decedent's gross estate:

"To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, * * *"

The provision of the Deed of Trust relied on by the Commissioner was paragraph 2 above quoted, by which the sons were permitted, with the settlor's approval during his life time, to obtain principal, thus cutting off the remainder interests. The value of these remainder interests the Commissioner accordingly added to the settlor's estate on the ground that by the deed he reserved control of their disposition. The Commissioner did not endeavor to subject to estate tax the value of the principal *at the settlor's death*, which value would include the remaining value of the life estates in the sons. Nor did he attempt to tax these life interests, apparently regarding them as irrevocably vested in the sons and beyond the settlor's control.

The interests taxed were solely the remainders after the life estates. The Tax Court sustained the Commissioner in subjecting these to tax despite paragraph 3 of the deed, above quoted, by which the settlor gave to each son the right presently, "by writing lodged with the trustees", and without obtaining any approval by the settlor, to direct the disposition of the principal to the son's relatives or to charities, and thus presently to eliminate entirely the interests of the contingent remaindermen.

Petitioners opposed the contention of the Commissioner on the ground that by virtue of paragraph 3 of the deed, above quoted, each son could, under Pennsylvania law, have obtained the principal of his trust during the settlor's life, without employing the provision of the deed relied on by the Commissioner. This they contended could have been effected in either of two ways:

1. Each son could, by writing lodged with the trustees during the life of the settlor, have appointed the remainder in his trust to one of his brothers, thus cutting off the remaindermen and rendering them no longer possible beneficiaries. The three brothers, without prior agreement on their part to do so, could then each have assigned the re-

mainder interest conveyed to him to the brother holding the life interest therein. Each brother, then having a life interest under a spendthrift trust followed by the remainder interest in the same principal, could, under Pennsylvania law[2] with the settlor's waiver of the spendthrift clause, have terminated the trust and secured an absolute interest in the whole principal. Such consent by the settlor would not have involved the use of the power reserved by paragraph 2 of the deed, and the consequent obtaining of the principal could have been equally effective had such paragraph 2 not been included in the deed.

2. The second method by which the sons, the life tenants, could similarly have obtained absolute control of the principal of their respective trusts, was by each of them, by writing lodged with the trustees and solely for the purpose of terminating the trust, appointing the remainder interest in his trust to his father, the grantor, as under paragraph 3 of the deed the testator had expressly given them power to do. Such an appointment would, ipso facto, have cut off the contingent remaindermen and rendered them no longer possible beneficiaries. The trusts could then have been terminated and the principal paid over to the sons upon the filing of a petition with the local county Orphans' Court by each son and the grantor, asking the Court to terminate the trusts and award the principal thereof to the sons.[3] The sons thus could have obtained the principal of the trusts without employing paragraph 2 of the deed, relied on by the Commissioner.

It was the petitioners' contention that decedent's estate could not be subjected to estate tax under Section 811(d)2 by virtue of a provision in the deed of trust the presence of which added nothing to the rights of the parties, under Pennsylvania law, apart from such clause, which was ex-

2. *Bowers Trust Estate*, 346 Pa. 85, 29 Atl. (2d) 519.
3. *Goodell's Estate*, 53 Pa. D & C 13 (1945).

pressly decided by this Court in *Helvering v. Helmholz*, 296 U. S. 93.[4]

The Tax Court, in sustaining the Commissioner's position, relied also on paragraph 4 of the deed, giving the trustees power to invade principal for the proper care, maintenance and education of the life beneficiaries, coupled with paragraph 6 giving the settlor power to direct the action of the trustees. This the Tax Court held to be a power to "alter, amend or revoke" within the meaning of Section 811(d)(2), although this power was but a contingent one and though the facts which permit an invasion of the corpus of the trust had never occurred.[5]

The Court of Appeals sustained the decision of the Tax Court's holding based on paragraph 2 of the deed. It held that the suggested procedure by which the sons would each have been enabled to get the principal (without employing paragraph 2) by appointing to one another was unavailing because it would constitute a "fraud on the power", despite the fact that it was predicated on the express consent of the settlor who had given the sons express power to cut off the contingent remaindermen. The Court of Appeals did not allude to or discuss the second procedure suggested, involving the appointment of the remainder interests back to the settlor. Nor did it pass on the applicability of the fourth and sixth paragraphs.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code (62 Stat. 928, U. S. C. Title 28, Section 1254) and Section 1141(a) of the Internal Revenue Code.

The judgment of the United States Court of Appeals for the Third Circuit to be reviewed was rendered on April 11, 1952, and a petition for rehearing, duly filed, was denied on May 8, 1952.

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4. See also *Hays v. Commissioner*, 181 F. (2d) 169.

5. *Estate of George H. Fiske*, 5 T. C. M. 42; *Daisy Christine Patterson Exec.*, 36 B. T. A. 407; *Estate of Clayton William Sherman*, 9 T. C. 594; *Estate of Edward Lathrop Ballard*, 47 B. T. A. 784, aff'd. on opinion below, 138 Fed. (2d) 512; *Helvering v. Tetsloff, et al. Exec.*, 141 Fed. (2d) 8.

STATEMENT OF QUESTIONS PRESENTED.

Where three inter vivos trusts, created by decedent in his lifetime for the benefit of his three adult sons, contained provisions by which the sons were given the power, with the approval of the decedent, to obtain the principal at any time, were the remainder interests in these trusts properly included in decedent's gross estate for estate tax purposes, in view of the fact that under the law of Pennsylvania it would have been possible for the sons to have obtained the principal of the trusts at any time during the lifetime of the decedent without utilizing in any way the provisions in question?

Whether Congress has power to tax the estate of a decedent because of a right reserved to consent to the disposal of trust property, which right added nothing to the rights of the parties apart from such clause.

REASONS FOR ALLOWANCE OF THE WRIT.

1. The Court of Appeals Has Decided a Federal Question in a Way in Conflict With the Decision of This Court in Helvering v. Helmholz, 296 U. S. 93.

In the decisions cited by the Court below and those relied on by the Commissioner, the courts have gone far in sustaining a tax based on a tenuous retention of control over the trust estate by a settlor. This Court, however, in *Helvering v. Helmholz*, 296 U. S. 93, drew the line at the point where the "reserved power" added nothing to the rights of the parties, conferred by local law as applied to the provisions of the deed of trust other than that reserving such power.

The rationale of this limitation on the scope of Section 811(d)(2) is believed to be that where by a deed of trust the beneficiaries are not presently given complete dominion over the trust property, but under local law they may obtain such complete dominion, the principal of the trust may not be included in the settlor's estate because of the insertion of a provision reserving to the settlor the right immediately to accord this complete dominion to the beneficiaries without their being required to avail themselves of such proceedings under local law.

In the *Helmholz* case, the decedent, with her father, mother, brothers and sisters (at least seven of them altogether), had joined in an indenture conveying to a trustee all the shares of stock in the Patrick Cudahy Family Company. Each of them was to receive for life the dividends on the shares contributed, and was given the right to appoint the principal, by will, with a gift over in default of appointment. Each of the parties (other than the trustee) was therefore both a settlor and a beneficiary.

The deed contained a clause providing for the termination of the trust by a writing delivered to the trustee signed by all the then beneficiaries other than testamentary appointees.

The Commissioner made the contention that the right of the beneficiaries, other than the testamentary appointees, to terminate the trust was equivalent to a power to revoke or to amend to be exercised by the decedent in conjunction with others. In answer to this argument, this Court said (page 97):

> "This argument overlooks the essential differences between a power to revoke, alter or amend and a condition which the law imposes. The general rule is that all parties in interest may terminate the trust. The clause in question added nothing to the rights which the law conferred. *Congress cannot tax,* as a transfer intended to take effect in possession or enjoyment at the death of the settlor, a trust created in a state whose law permits all the beneficiaries to terminate the trust." (Emphasis supplied.)

If by a deed of trust a settlor provided a life estate on a spendthrift trust with full power by the life tenant to appoint the principal by writing during his lifetime, the life tenant, except for the spendthrift provision, would be empowered presently to obtain complete control of the principal. Under the Pennsylvania decisions[6] however, the settlor might waive or lift the spendthrift provision and make this presently possible. Certainly Section 811(d)(2) would not be applicable to such a case merely because of the spendthrift provision, which is not a reservation of a power in the settlor, but merely a limitation on the rights of the life tenant; otherwise every deed of trust containing a spendthrift clause would be taxable to the settlor, a position which has never been taken by the Commissioner. The addition to such a deed of an express clause similar to paragraph 2 in the Hauptfuhrer deed of trust would not, therefore, under *Helvering v. Helmholz,* subject the principal to tax.

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6. *Bowers Trust Estate,* 346 Pa. 85, 29 Atl. (2d) 519.

If the Hauptfuhrer deed of trust had not contained paragraph 2, relied on by the Commissioner, the sons would each have had life estates on a spendthrift trust, with power to appoint the remainder to relatives or charities, by virtue of which power they could have appointed either to a brother or to the father, the settlor, whereupon, with the settlor's concurrence, they could have acquired the absolute ownership of the principal. The mere fact that in order to bring this about the settlor would have to waive the spendthrift trust clause would not make the principal taxable, and the mere gratuitous addition of paragraph 2, providing a similar method by which the same result could be brought about cannot be available under Section 811(d)(2) to subject the principal to estate tax.

By his "irrevocable" deed Hauptfuhrer parted with all real control and dominion over the property. The only right retained by settlor was to approve payment of principal to the sons during his lifetime, which right the law already gave him, lifting the spendthrift clause. The sons, having power to appoint by deed the principal after their life estates to any relative or charity, could have at once cut off the contingent remaindermen. They with their father were hence, or had it in their power to become, the sole beneficiaries. Since they, as constituting "all parties in interest," could then have terminated the trust *without invoking* paragraph 2 relied on by the Commissioner, the decision of this Court in *Helvering v. Helmholz* is directly applicable and should have been followed by the Court below.

The cases relied on by the Court below are all distinguishable in that in each of those deeds, the power retained by the settlor to alter, amend or revoke was exercisable by the settlor alone or in conjunction *with some, but not all,* of the beneficiaries of the trust having an interest therein, vested or contingent, and the exercise of said power would have resulted in the immediate distribution of the trust

estates to persons who otherwise would not or might not have received any of it at all. That is not the case here, as the power of the settlor is exercisable only in conjunction with all the beneficiaries who have indestructible interests in the trust estates, and its exercise would not have resulted in the immediate distribution of the trust estate to persons who otherwise would not or could not receive the same.

2. The Court of Appeals Has Decided an Important Question of Pennsylvania Law in a Way in Conflict With the Pennsylvania Decisions.

The decision of the Court below can be sustained only if the trust could not, under Pennsylvania law, be terminated without resort to the right retained by the settlor under paragraph 2 of the trust deed; for then the power so retained by settlor would be one to alter, amend or revoke in conjunction with some but not all of the beneficiaries of the trust, and the cases cited by the Court below would be applicable. However, under Pennsylvania law, this trust *could* have been terminated and the principal thereof paid to the sons without resort to the right retained by the settlor under paragraph 2 of the trust deed.

The Court below apparently recognized that, under *Bowers Trust Estate,* 346 Pa. 85, 29 Atl. 2d 519, all the beneficiaries of a spendthrift trust could, with the concurrence of the grantor during his life, terminate the trust and secure the principal. It however held that this decision was inapplicable because, in the case at bar, for the sons to cooperate in obtaining the principal of their respective trusts would be a "fraud on a power."

"The consent," said the Court, "of the settlor to such a scheme does not convert otherwise ineffective appointments into valid ones. Having created interests in at least some of the objects of the appointment, and remainders in the takers in default, the settlor could not, in the absence of a reserved power of termination, extinguish these interests."

The error of the Court below in thus construing and applying the Pennsylvania decisions was in failing to appreciate that there was no one on whom it could be said that a "fraud" would be practiced by the proposed procedure. Certainly, despite the Court's statement, the interests in remainder could not be said to suffer a legal injury by having their interests cut off by the life tenants pursuant to the express power given them by the grantor in the 3d clause to appoint these remainders without the grantor's concurrence, away from them, to any relative or charity.

The rationale of the doctrine of fraud on powers is that the attempted exercise of a special power in favor of non-objects of the power defeats the intent of the donor that the power shall be exercised exclusively for the benefit of the objects of the power; *Restatement of the Law of Property, Section 352,* (*Comment a*). Since the grantor would expressly concur in the procedure, it certainly could not be said that he would be defrauded, or that the exercise thereof was foreign to his intent. Moreover, the said procedure would not constitute an appointment to non-objects of the power. An analysis of the deeds of trusts shows that the settlor gave to each of his three sons immediate dominion over the remainder interests with the power arbitrarily to terminate them forthwith without the settlor's further consent. It is apparent, therefore, that the objects of the settlor's bounty were the sons, and that the exercise of the power, as herein suggested, would not be in favor of non-objects of the power, but rather in favor of the objects of the power, and, therefore, a proper exercise thereof.

In the *Bowers* case, *supra,* Mrs. Bowers had given a fund in trust to pay her the income on a spendthrift trust with remainder to her son. It was held that the son might properly convey his interest to his mother and that she, having the complete interest therein, could terminate the trust.

In *Goodell's Estate,* 53 Pa. D. & C. 13 (1945), the settlor, under an inter vivos trust, reserved to himself

the income for life with provision for the distribution of principal and income upon his death. The deed contained spendthrift provisions with respect to both principal and income. The settlor reserved to himself the right to make any change with respect to the distribution of principal and income of the trust provided that *no such appointment as to principal should be in favor of settlor himself, or of his estate.* By deed dated March 27, 1944, the settlor amended that trust by providing that upon his death, the principal be paid to his mother, her executors, administrators or assigns. On March 27, 1944, the same day the trust was amended, the settlor and his mother executed a petition which was filed in the Orphans' Court of Philadelphia County, requesting the Court to terminate the trust and to award the balance of principal and income to the settlor. The Court allowed the petition and awarded the entire trust estate to the settlor, even though, as pointed out by the Court in its Opinion, it was permitting the settlor to effect what would appear to be a direct contravention of the provisions of the original deed of trust that no appointment as to principal would be in favor of the settlor himself, or his estate. The Court was of the opinion that the *Bowers Trust Estate, supra,* was authority for the termination of the trust. It is apparent that the amendment to the deed of trust, by which the settlor appointed the remainder interest to his mother, was for the sole purpose of terminating the trust and having the principal thereof awarded to him. Applying the doctrine of the *Goodell* case to the instant case, the exercise of the power by each son in favor of their father for the sole purpose of terminating his trust would be a proper exercise of the power.

Conversely, in *Ammon's Trust Estate,* 52 Pa. D. & C., 509 (1944), Edward Ammon had given funds in trust to pay the income to Mary Ammon for life on a spendthrift trust; on her death the principal was made payable to settlor if living, otherwise to his executor or administrator,

or to such persons as were designated as beneficiaries in his last will and testament. He executed an assignment of all his interest to Mary, the life beneficiary, and consented to the termination of the trust, which the Court held effective despite the spendthrift clause.

In the case at bar, each son could, by a writing lodged with the trustees and solely for the purpose of terminating the trust, have appointed the remainder interest to settlor. The full interest in each trust would then have been lodged in each son and settlor. The trusts could then have been terminated (as in the *Goodell* case) and the principal thereof paid over to the sons upon the filing of a petition with the local county Orphans' Court by each son and the grantor, asking the Court to terminate the trust and award the principal thereof to the sons, even though no power of termination was expressly reserved in the trust instrument. It is apparent, therefore, that the clause giving the settlor the right in conjunction with the life beneficiary to terminate the trust added nothing to his right in that respect which he already had under State law. If the trusts contained no such provision, the Commissioner would not have included the remainder interests therein in the decedent's gross estate, and yet the settlor would have had the same power of termination under State law. If such a power given a settlor by State law is not a taxable power, how can the same power spelled out in the trust instrument and merely declaratory of State law be a taxable power? Obviously such a power is not a taxable power.

3. The Court of Appeals Has Rendered a Decision in Conflict With That of the Court of Appeals for the Fifth Circuit in Hays v. Commissioner, 181 F. (2d) 169.

In *Estate of Mary H. Hays v. Commissioner,* 181 F. 2d 169, decided by the Court of Appeals for the Fifth Circuit, April 14, 1950 (reversing the Tax Court, 12 T. C. 210), the decedent had conveyed land to herself as

trustee, to divide the interest between designated beneficiaries, with the right to withhold income in her discretion for the best interest of the beneficiaries. The trust was to continue to the death of the grantor unless prior thereto the trustee deemed it to the best interest of the beneficiary to terminate it, in which case she might do so. On the termination of the trust, either by the death of the grantor or by the trustee prior thereto, the trust estate was distributable immediately to the beneficiaries. In the event of the death of any of the beneficiaries, the interest of any such beneficiary passed to his or her heirs. Such interests were on a spendthrift trust.

The Commissioner and the Tax Court considered that the trust estate was taxable in the estate of the grantor because of her reserved right to terminate the trust. The court of appeals, however, pointed out that the beneficial interest was in the beneficiaries, and that the right reserved by the grantor was merely to hand such interest over to the beneficiaries who in any event would have been ultimately entitled to receive it. The mere fact that she might terminate the trust and eliminate the spendthrift trust provisions was held not sufficient to subject the property to taxation as part of her estate.

This decision is directly in point, and essentially in conflict with that in the case at bar. The three Hauptfuhrer sons had power given them under the deed *without any approval by the settlor* to acquire the remainder interests in themselves absolutely. Having done so, they would have had the entire beneficial interest, just as the Hays children had, subject only to the spendthrift trust which, under Pennsylvania law, the settlor had the right and power to waive.

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

HENRY S. DRINKER.

FREDERICK E. S. MORRISON,
Counsel for petitioners.

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 142

ESTATE OF HENRY HAUPTFUHRER, DECEASED, HENRY HAUPTFUHRER, JR., GEORGE J. HAUPTFUHRER, AND ALBERT F. HAUPTFUHRER, EXECUTORS, *Petitioners*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion and findings of fact of the Tax Court (R. 47-62) are unreported. The opinion of the Court of Appeals (R. 76-83) is reported at 195 F. 2d 548.

JURISDICTION

The judgment of the Court of Appeals was entered on April 11, 1952. (R. 84.) A petition for

rehearing was denied on May 8, 1952. (R. 93.) The petition for a writ of certiorari was filed June 20, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254.

QUESTION PRESENTED

Whether the value of the remainder interests in three separate trusts, which had been created by the decedent in 1933, was includible in his gross estate under Section 811 (d) (2) of the Internal Revenue Code, because of the fact that the decedent had reserved a power to distribute part or all of the principal to the life beneficiaries.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and Regulations involved are set forth in the Appendix, *infra,* pp. 13-19.

STATEMENT

This is a proceeding involving an estate tax deficiency determined by the Commissioner of Internal Revenue (R. 8-15) against the Estate of Henry Hauptfuhrer, deceased (hereinafter referred to as the taxpayer). A number of issues were submitted to the Tax Court for decision (R. 47), but only one of them was brought to the court below on review, and that was the issue as to whether the value of the remainder interests in three *inter vivos* trusts created by the decedent was includible in his gross estate. The facts found

by the Tax Court with respect to that issue (R. 47-50) may be stated as follows:

The decedent, a resident of Pennsylvania, in 1933 created separate trusts for his three sons, George J., Henry, and Albert F. Hauptfuhrer.[1] In each of the trusts, the three sons were named as individual trustees and a corporate trustee was named. In each of the trusts, one of the sons was named life beneficiary and was given a power of appointment[2] over the remainder interest, which upon failure of the power was to go to the surviving children per stirpes, or heirs at law. Each trust instrument also contained a provision permitting the life beneficiary, with the consent of the grantor, to terminate the trust and have distributed to him both the income and principal thereof. (R. 47-48.)

The pertinent provisions of the trust for Henry, which were identical for all material purposes with those of the other trusts, were as follows (R. 48-50):

> In Trust, to pay and distribute the net income from the trust estate at least quarter-

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[1] Copies of the three trust indentures are contained in the record as Petitioners' Exhibits 1, 2 and 3, respectively. (R. 18-46.)

[2] The Tax Court described this as a general power (R. 47) although the sons could appoint only to relatives or charities. (R. 19, 29, 39.) The Court of Appeals properly characterized it as a special power. (R. 81.)

yearly unto Henry Hauptfuhrer, Jr., during his life; and

IN TRUST, during the life of Henry Hauptfuhrer, Jr., to pay and distribute unto him such part or parts or the whole of the principal of the trust estate as he shall, by writing lodged with the Trustees request, provided such request be in writing approved by the Settlor during his lifetime, and after the decease of the Settlor by the Trustees, or a majority of them, and to the extent of such distribution of principal the interests of all persons therein shall be thereby terminated and ended; and

IN TRUST, from and after the death of Henry Hauptfuhrer, Jr., then to pay and distribute the net income from the then remaining trust estate, if any, and the then remaining principal thereof unto and among such person or persons related to Henry Hauptfuhrer, Jr., by blood or marriage and/or for such charities or religious purposes as Henry Hauptfuhrer, Jr., by writing lodged with the Trustees or by last will and testament, shall nominate and appoint, in such manner, at such times and for such interests as he shall determine; and any part of the trust estate, both income and principal, which shall not be or become subject to distribution under the power aforesaid shall be paid and distributed

upon the death of Henry Hauptfuhrer, Jr., unto his then surviving children and issue, children and issue to take by presentation, per stirpes * * *; and

IN TRUST, anything hereinbefore to the contrary notwithstanding, if by reason of misfortune, lack of income or other cause, the share of principal and/or income payable to any person hereunder shall not be sufficient, in the opinion of the Trustees, for the proper care, maintenance, education and support of such person, then the Trustees shall be entitled, in their sole and absolute discretion, to apply out of the principal from which such person is receiving or entitled to receive income, or out of the residuary trust estate, such part or parts thereof as the Trustees shall determine, and to the extent of such application the interest of all persons therein shall be thereby diminished; * * *.

It is hereby expressly stipulated and agreed that all payments of income and/or principal payable to any person hereunder shall, to the fullest extent permitted by law, be free and clear of his or her debts, contracts, engagements, alienations and anticipations, and that the same shall not be liable to any levy, attachment, execution or sequestration.

* * * *

> It is hereby expressly stipulated and agreed that during the life of the Settlor the Settlor shall be entitled to direct and control the exercise by the Trustees hereunder of the powers and authority herein conferred upon the Trustees * * *.
>
> * * * *
>
> The Settlor hereby expressly agrees that the trust created hereby is irrevocable, and that the trust estate and all rights, powers and authority hereunder vested in the Trustees, and their successors, and/or the survivor or survivors of them, upon the date hereof without any right being reserved in the Settlor to receive any principal or income from the trust estate, or to alter, amend or modify any rights or interest therein; and the Settlor hereby ackknowledges this trust and the said assignment and transfer to be irrevocable and to be vested as aforesaid.

In determining the estate tax deficiency, the Commissioner, in addition to making several other adjustments not here material, included in the gross estate the value[3] of the remainder interests in each of the trusts, after the life estates in the three sons, "because * * * the decedent had reserved a power to alter, amend or revoke within the meaning of Section 811 (d)(2) of the Internal Revenue Code." (R. 14, 50.)

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[3] There was no question in the case as to the amounts determined to be the value of the remainder interests.

The Tax Court upheld the Commissioner's action. (R. 50-54.) The court below affirmed. (R. 76-83.)

ARGUMENT

1. Section 811 (d)(2) of the Internal Revenue Code (Appendix, *infra*, pp. 13-14), which applies to transfers made on or prior to June 22, 1936, provides for the inclusion in the gross estate of property transferred (donatively) by the decedent in trust or otherwise, where the enjoyment thereof was subject at his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke.

In this case, each of the trust instruments provided that the trustees, with the approval of the settlor (the decedent), could distribute to the life beneficiary all or such part of the principal as he might request. Thus the decedent reserved the power (in conjunction with the trustees, whose action he was expressly empowered to direct and control) to distribute to the life beneficiary all or part of the principal. Because of that reserved power in the decedent to distribute corpus to the sons, the court below upheld the inclusion of the value of the remainder interests in the three trusts in the decedent's gross estate under Section 811 (d)(2) of the Code.[4]

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[4] In addition to holding the remainder interests taxable upon this ground, the Tax Court had also thought them taxable because of the power given the trustees to invade princi-

Through that reserved power, the decedent could convert the limited rights of the sons to absolute dominion over the principal of the trusts, bring about the termination of the trusts and thereby cut off the remainder interests. Clearly, the exercise of the power would have affected the scheme for the enjoyment of the property in such a substantial way as to justify the taxing of the value of the remainder interests under Section 811 (d)(2) of the Code. The decision below is correct, is in keeping with the principles enunciated by this Court in *Commissioner* v. *Estate of Holmes,* 326 U. S. 480, and is in accord with decisions of the lower courts in numerous other cases.[5] No occasion is presented for any further review of the question.

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pal for the proper care, maintenance and education of the life beneficiaries, which provision, in conjunction with the settlor's power to direct the action of the trustees, likewise constituted a power in the settlor within the meaning of Section 811 (d)(2) of the Code. (R. 53-54.) The court below regarded it unnecessary to pass upon that additional ground. (R. 83.)

[5] See, for example, *Mellon* v. *Driscoll,* 117 F. 2d 477 (C.A. 3d), certiorari denied, 313 U.S. 579; *Commissioner* v. *Hofheimer's Estate,* 149 F. 2d 733 (C.A. 2d); *Commissioner* v. *Newbold's Estate,* 158 F. 2d 694 (C.A. 2d); *Thorp's Estate* v. *Commissioner,* 164 F. 2d 966 (C.A. 3d), certiorari denied, 333 U.S. 843; and *Loughridge's Estate* v. *Commissioner,* 183 F. 2d 294 (C.A. 10th), certiorari denied, 340 U.S. 830. See also Treasury Regulations 105, Sec. 81.20. (Appendix, *infra,* p. 15.)

2. The case of *Hays' Estate* v. *Commissioner*, 181 F. 2d 169 (C.A. 5th), with which the decision below is alleged to be in conflict (Pet. 15-16), is clearly distinguishable.[6] There, the reserved power of termination merely would have permitted the same beneficiaries to take earlier the same portion of the trust estate they would have otherwise taken on the grantor's death. Here, the reserved power would have made it possible for the sons to receive principal which they otherwise would not have received—all they could have done otherwise was to appoint to relatives or charities, in default of which the principal would have gone to the children and issue of the sons.

3. The court below correctly rejected (R. 81-83) the taxpayer's contention that the reserved power was not needed because each son could have appointed the remainder in his trust to another son, and then each would agree to exchange the remainder thus received for the remainder in his own trust, with the result that each son would then have a life estate, subject to a spendthrift provision, with a remainder in himself—and since the settlor could waive the spendthrift provision, each trust could thus have been terminated.

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[6] Moreover, there is room for serious doubt whether, in the light of this Court's decision in the *Holmes* case, the *Hays'* case was correctly decided. Cf. *Zirjacks* v. *Scofield* (C.A. 5th), decided June 30, 1952.

As the court below recognized (R. 82), the argument is ingenious, but wholly without merit. It is clear from the trust instruments that, while the grantor was willing to let the sons dispose of the principal after their life estates by appointment to relatives or charities, he was not willing to let the sons take any principal *themselves*—except upon his own approval, or, after his death, the approval of a majority of the trustees. As properly indicated by the court below (R. 82), circumvention by the suggested maneuvers of the plain provisions of the trust instruments, prohibiting the sons from taking for themselves, would not have been possible.[7] In the absence of a reserved power of termination, the sons could not have taken principal. The court below was therefore correct in concluding (R. 83) that the "reserved power of termination was thus not surplusage; it was a vital part of the trust indentures".

Hence, there is no conflict, as alleged (Pet. 9-12), with the decision of this Court in *Helvering* v. *Helmholz*, 296 U.S. 93.

4. The taxpayer concedes the correctness of the decision below if the trusts could not, under

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[7] For the same reason, there is likewise no merit in the other suggested maneuver (Pet. 6), whereby each son would appoint the remainder in his own trust back to the settlor, and the two of them then allegedly could have the trust terminated upon application to a local court.

Pennsylvania law, be terminated without resort to the reserved power in question, but asserts that under the law of that State the trusts could be so terminated. (Pet. 12.) The taxpayer's argument (Pet. 12-15), to the effect that the court below has decided a question of Pennsylvania law in conflict with Pennsylvania decisions, rests on nothing more than the same claimed effect of the suggested maneuvers whereby, it is asserted, termination could have been brought about without resort to the reserved power. As already brought out, the suggested maneuvers would have been ineffective to bring about termination of the trusts in the absence of a reserved power. Here, there were gifts over in default of appointment, and those remainder interests could not have been cut off by the grantor and the sons, in the absence of the reserved power in question. Contrary to the taxpayer's assertion, the court below has correctly interpreted and applied the law of Pennsylvania. See *McCreary Trust,* 354 Pa. 347; *Johnson* v. *Provident Tr. Co. of Phila.,* 280 Pa. 255. See also, *Kamerly Estate,* 348 Pa. 225; *Africa Estate,* 359 Pa. 567; Restatement, Trusts, Sec. 338 (comment f), and Sec. 340 (comment d); and Restatement, Property, Secs. 351-354.

Cases such as *Bowers' Trust Estate,* 346 Pa. 85, *Goodell's Estate,* 53 Pa. D. & C. 13, and *Ammon's Trust Estate,* 52 Pa. D. & C. 509, relied upon by the taxpayer (Pet. 12-15), are clearly inapplicable,

since they involve situations not at all similar to the instant case.[8]

CONCLUSION

The decision below is correct. It turns upon the particular facts of the case and presents no question calling for further review by this Court. There is no conflict of decisions. The petition should, therefore, be denied.

Respectfully submitted,

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JULY, 1952.

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[8] Such cases stand for the general proposition, as stated in the *Bowers'* case (346 Pa. at p. 87), to the effect that—

> If all the parties who are or may be beneficially interested in a trust are in existence and sui juris, if there is no ultimate purpose of any kind requiring its continuance, and if all the beneficiaries consent, a court of equity will decree its termination; of course, if there are contingent remaindermen not in existence or not ascertained, the trust cannot be terminated since it is then impossible to obtain the consent of all possible interests.

APPENDIX

Internal Revenue Code:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * * * *

(d) *Revocable Transfers*—

(1) Transfers after June 22, 1936.— * * *

(2) Transfers on or prior to June 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross

estate under paragraph (1) unless it is includible under this paragraph;

(3) Date of existence of power.—For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

* * * * * * *

(h) *Prior Interests.*—Except as otherwise specifically provided therein, subsections (b), (c), (d), (e), (f), and (g) shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as

severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after February 26, 1926.

* * * * * * *

(26 U.S.C. 1946 ed., Sec. 811.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

SEC. 81.20. *Transfers with power to change the enjoyment.*—(a) *Transfers included.*—Subsection (d) of section 811 embraces a transfer by trust or otherwise (if not amounting to a bona fide sale for an adequate and full consideration in money or money's worth) when at the time of decedent's death the enjoyment of the transferred property, or some part thereof or interest therein, was subject to any change through a power exercisable either by the decedent alone, or by him in conjunction with some other person or persons, to alter, or amend, or revoke, or terminate. (See section 81.15.)

The addition to subdivision (d) (1) of the Revenue Act of 1926, by section 805 of the Revenue Act of 1936, of the phrase to the effect that it is not material in what capacity the power was subject to exercise by the decedent or by the other person or persons in conjunction with the decedent (which phrase is also embodied in subsection (d) (1) of section 811 of the Internal

Revenue Code), is considered merely declaratory of the meaning of the subdivision prior to the addition of the phrase.

The second phrase added to this subdivision of the Revenue Act of 1926 by amendment in 1936 (also embodied in section 811 (d) (1) of the Internal Revenue Code), namely, "without regard to when or from what source the decedent acquired such power," is not considered declaratory of the meaning of the subdivision prior to the amendment in a case in which no one of the powers enumerated in the subdivision was reserved at the time of the making of the transfer, but one or more thereof were conferred subsequent thereto (whatever the source from which conferred) without any understanding, expressed or implied, had in connection with the making of the transfer that such power or powers should be later conferred.

The third change made in the subdivision by the Revenue Act of 1936 (which is also embodied in subsection (d) (1) of section 811 of the Internal Revenue Code) consists of the addition of the words "or terminate" following the words "to alter, amend, revoke." Such addition is considered but declaratory of the meaning of the subdivision prior to the amendment. A power to terminate capable of being so exercised as to revest in the decedent the ownership of the transferred property or an interest therein, or as otherwise to inure to his benefit or the benefit of his estate, is, to that extent, the equivalent of a power

to "revoke," and when otherwise so exercisable as to effect a change in the enjoyment, is the equivalent of a power to "alter."

(b) *Taxability.*—The property or any interest therein transferred as described in subsection (a) shall be included in the gross estate if it comes within any one of the following paragraphs:

(1) If the transfer was made prior to the enactment of the Revenue Act of 1924 (4:01 p.m., eastern standard time, June 2, 1924), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons having no substantial adverse interest or interests in the transferred property, or if exercisable in conjunction with a person having a substantial adverse interest or with several persons some or all of whom held such an adverse interest, then to the extent of any interest or interests held by a person or persons not required to join in the exercise of the power and to the extent of any adverse interest which was not substantial.

(2) If the transfer was made after the enactment of the Revenue Act of 1924 (4:01 p.m., eastern standard time, June 2, 1924) and before the amendment of the subdivision by the Revenue Act of 1936 became effective (June 23, 1936), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons either having or

not having a substantial adverse interest or interests in the transferred property, or in conjunction with persons one or more of whom had and one or more of whom had not such an adverse interest.

(3) If the transfer was made after June 22, 1936 (the date of the enactment of the Revenue Act of 1936), and the power was either reserved at the time of the transfer or later created or conferred, without regard to the source from which the power was acquired, and whether exercisable by the decedent alone or in conjunction with a person or persons either having or not having a substantial adverse interest or interests in the transferred property, or in conjunction with persons one or more of whom had and one or more of whom had not such an adverse interest.

As used in this and in the next succeeding section, the expression "reserved at the time of the transfer" refers to a power to which the transfer was subject when made, whether the power arose by implication of law or by the express terms of the instrument of transfer, and which continued to the date of decedent's death (see the paragraph next following as to the conditions under which the power will be considered as existent at decedent's death) to be exercisable by decedent alone or by him in conjunction with some other person or persons, and includes any understanding, expressed or implied, had in connection with the

making of the transfer that the power should later be created or conferred.

The power to alter, amend, revoke, or terminate will be considered to have existed on the date of the decedent's death, though the exercise of the power was subject to a precedent giving of notice, or though the alteration, amendment, revocation, or termination would take effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice had been given or the power had been exercised, or though the exercise of the power was restricted to a particular time which had not arrived, or the happening of a particular event which had not occurred, at decedent's death. In determining the value of the gross estate in such cases the full value of the property transferred subject to the power should be discounted for the period required to elapse between the date of decedent's death and the date upon which the alteration, amendment, revocation, or termination could take effect. (See section 81.10 (i) (3).)

The provisions of this section do not apply to a transfer if the power may be exercised only with the consent of all parties having an interest, vested or contingent, in the transferred property, and if the power adds nothing to the rights of the parties as conferred by the applicable local law.

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